

# Chief Financial Officer's Analysis of EPA's Fiscal Year 2003 and 2002 Financial Statements

## Summary of Auditor's Report and Opinions

The Environmental Protection Agency (EPA) prepared the following Fiscal Year (FY) 2003 Financial Statements: Statement of Financial Position (Balance Sheet), Statement of Changes in Net Position, Statement of Net Cost, Statement of Budgetary Resources, Statement of Financing, and Statement of Custodial Activity. In addition, we prepared a Statement of Net Cost by Goal for each of the Agency's 10 Strategic Goals.

The Office of Inspector General (OIG) stated: "In our opinion, the consolidating financial statements present fairly, in all material respects, the consolidated and individual assets, liabilities, net position, net cost, net cost by goal, changes in net position, budgetary resources, reconciliation of net cost to budgetary obligations, and custodial activity of the U.S. Environmental Protection Agency and its subsidiary funds, the Superfund Trust Fund and all other Appropriated Funds, as of and for the years ended September 30, 2003 and 2002, in accordance with accounting principles generally accepted in the United States of America."

## Report on Internal Controls

The OIG Audit Report on the EPA's Fiscal 2003 and 2002 Financial Statements did not identify any material weaknesses.<sup>1</sup> However, the report cited eight reportable conditions. These reportable conditions are summarized below, along with a short statement of the Agency's position with respect to each of those items.

### Documentation and Approval of Standard Vouchers.

The OIG noted that the Agency did not always adequately document standard vouchers for transfer requests from Treasury to EPA Trust Fund accounts (Superfund and Leaking Underground Storage Tank funds) prior to the transactions being entered into the Integrated Financial

Management System (IFMS). The OIG indicated that establishing written procedures to calculate the monthly transfer process would reduce the potential for errors. The Office of the Chief Financial Officer (OCFO) will issue procedures in support of this process.

### Improvement Needed in EPA's Interagency Agreement Invoice Approval Process.

The OIG noted that EPA project officers did not always fulfill their oversight duties related to reviewing and approving Interagency Agreement (IAG) invoices. EPA agrees that improvement is needed. The Grants Administration Division will provide more in-depth training for project

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<sup>1</sup> A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce, to a relatively low level the risk, that misstatement of amounts would be material in relation to the financial statements being audited and would not be detected within a timely period by employees in the normal course of performing their assigned functions.

officers on IAG core competencies and emphasize the importance of collecting and reviewing invoice documentation to substantiate costs.

#### Improvement Needed in Reconciling State Superfund Contracts Unearned Revenue.

The OIG recommended that EPA reconcile the unearned revenue from State Superfund Contracts (SSC) to the general ledger balance. EPA agrees to analyze and reconcile SSC expenditures annually.

**EPA Did Not Promptly Record Marketable Securities Received in Fiscal Year 2003.** The OIG noted two instances where marketable securities received in FY 2003 in the settlement of debts were not promptly recorded. The OCFO will issue policy and procedures to standardize the process for recording marketable securities within the Agency.

**Automated Application Processing Controls for the Integrated Financial Management System Could Not be Assessed.** The OIG was unable to assess automated application processes and controls for the IFMS. The OIG made no recommendations in this area. The OCFO has a planned target date of 2006 for replacing IFMS. A commercial-off-the-shelf package will be delivered with applicable documentation.

**Integrated Financial Management System (IFMS) Suspense File Needs to be Reconciled to the General Ledger.** The OIG recommends that the OCFO establish and test a formal reconciliation process that includes total dollars and record counts for the data processed from the IFMS suspense file to the general ledger accounts. OCFO agrees with the OIG's recommendation. An automated reconciliation is currently in the testing and validation phase. Further, a policy is in place that establishes the policies and procedures for reconciling the IFMS suspense file to the general ledger.

#### Further Improvements Needed in Managing EPA's Accounts Receivable.

The OIG noted two issues that impact EPA's accounting for accounts receivable: (1) untimely recording of receivables by some Financial Management Offices (FMO) due to late submission of supporting documentation from the Department of Justice, Regional Counsel, or the program offices, and (2) one region's improper allowance for doubtful accounts calculation, which was subsequently properly adjusted. The OCFO will develop necessary policies and procedures to ensure legal documents are promptly forwarded. OCFO has implemented procedures to: (1) verify that year-end or period-end transactions are processed, and (2) review the allowance for doubtful accounts and update percentages based on collection experience from prior years. The OCFO will continue to work with the FMOs to ensure that these policies and procedures are understood and properly followed.

**Internal Controls for Correcting Errors in the Integrated Financial Management System Need Improvement.** The OIG recommends that the Agency use a standardized approach when making systemic corrections. The OCFO believes that existing Agency policy documents the procedures for processing financial transactions. However, the OCFO is currently in the process of updating related Standard Operating Procedures to insure that future transactions are processed using the standard accounting protocol.

## Compliance with Laws and Regulations

### NONCOMPLIANCE ISSUES WITH FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT (FFMIA)

The OIG identified no substantial non-compliance issues with FFMIA, however, four other noncompliances were noted.

**EPA Continues to Make Efforts to Improve Its Cost Accounting Processes.** The OIG recommends that the OCFO continue to improve Agency financial and cost accounting systems, and educate users on the types of information available from within those systems. Further, the OIG would like the Agency to reconsider the use of the Program Results Code as a cost accounting output.

EPA has a cost information assessment under way, designed to further educate users on the benefit of cost information. The assessment is designed to elicit from Agency managers additional cost information needs and assist them in identifying types of information currently available in OCFO systems. OCFO will continue to work with Agency managers and staff to identify their cost information needs and incorporate those requirements into the Agency's accounting processes, where practical.

The Agency's cost accounting output will continue to be the subobjective. Having the Agency output as a subobjective does not preclude the Agency from accounting for discrete programs or projects below the subobjective level. The revised accounting structure for the new strategic plan will allow the Agency to do just that. For example, the Agency currently accounts for projects below the subobjective level in the Superfund Program. Phase II of the cost information assessment will identify other projects and activities that may be at a level lower than subobjective or even below the Program/Project level. If practical to do so, the Agency will establish procedures to collect cost information in the Agency's accounting system.

**EPA Continues to Experience Difficulties in Reconciling Intragovernmental Transactions.** The OIG referenced government-wide difficulties in reconciling intragovernmental transactions. The OIG did not make any specific recommendations at this time; however, the OIG did encourage EPA to continue its efforts in reconciling the Agency's intragovernmental transactions to comply with Federal reporting requirements. The OCFO will continue its efforts to reconcile intragovernmental transactions and meet the Federal reporting requirements.

**EPA Needs to Revise and Resubmit Federal Financial Management Improvement Act Remediation Plan.** The OIG reported that the EPA had failed to implement the personnel certification program for granting access to non-Federal personnel (e.g., contractors) as provided in its 1999 Remediation Plan.

EPA's 1999 Remediation Plan has been updated and submitted to the OMB. The updated plan shows (1) that the Office of Administration and Resources Management is the party responsible for establishing a security certification process for non-federal workers, and (2) the estimated milestones for issuing the security certification policy is July 2004 for contractor personnel, and July 2005 for grantee personnel. The revised Remediation Plan was included in the FY 2004 - FY 2009 Financial Management Five Year Plan and provided to the Office of Management and Budget in October 2003.

The OCFO has also taken steps to ensure that a certification process for contractors using EPA's IFMS is in place. This certification process is outlined in OCFO Policy Announcement No. 98-08.

The audit report also stated that EPA's Memorandums of Understanding (MOUs) with other financial or mixed systems that interface with IFMS do not stipulate clear

baseline security requirements for screening contractor personnel with access to financial data. EPA believes that IFMS MOUs clearly reference the Interconnection Security Agreement which requires compliance with IFMS' Security Plan. Under the Security Plan, background screening is required for contractor personnel. Further, OCFO has surveyed its interfacing system owners (i.e., EPAYS, IDOTS, and CPS) and found that contractor personnel do not have access to them.

#### EPA Not in Compliance Regarding Preparation and Reconciliation of SF 224.

The OIG reported that EPA continues to experience difficulties in completing the

required SF 224 "Statement of Transactions" and reconciling transactions on the Statement of Differences (FMS 6652) as required by Agency policy and Treasury's Financial Manual. The OCFO disagrees with the OIG's assessment that the entire Agency is not in compliance with Treasury's regulations since the majority of the FMOs comply with the regulations. The OCFO has advised the OIG that only one accounting point continues to adjust amounts via the SF 224. Also, the OCFO has provided the OIG with an analysis indicating that any suspense differences between IFMS and the SF 224 are insignificant.

## Progress in Correcting Previously Identified Problems

OCFO management believes that audit follow-up is an integral part of good management and that corrective actions are essential to improving the effectiveness and efficiency of government operations. To resolve long-standing audit recommendations, the OCFO formed an Audit Follow-Up Council in July 2000 to review progress on audit findings, discuss approaches to resolving audit issues, and provide coordination and support across the OCFO on audit related matters.

As a result of the Council's efforts, the Agency has resolved several long-standing issues. During the audit of the FY 2002 financial statements, the OIG noted substantial progress in completing a number of corrective actions from prior years. For FY 2003, the Agency and the OIG are currently working to resolve several remaining issue areas from prior financial statement audits. Those areas are as follows:

**Automated Application Processing Controls for IFMS.** The OIG continues to acknowledge that the Agency plans to replace IFMS with a new automated accounting system. Until the new system is installed, the OIG will continue to mention this area as a reportable condition. EPA is on track to replace IFMS with a planned target date of 2006.

**Financial System Security Plans.** The OIG believes that the Agency has established a personnel security policy for access to IFMS. However, it is not clear what is required of non-Federal personnel for access to other financial and mixed-financial systems. The OIG recommended that EPA revise the 1999 FFMIA Remediation Plan, establish a milestone for completion, and submit the revised Plan to OMB. The OCFO has updated the EPA Remediation Plan and has submitted it to the OMB. The milestones for issuing the policy are July 2004 for contractor personnel and July 2005 for grantee personnel.